

**STATE OF UTAH INSURANCE DEPARTMENT**

**REPORT OF EXAMINATION**

**OF**

**OPTICARE OF UTAH, INC.  
OF  
WEST VALLEY CITY, UTAH**

**AS OF**

**September 30, 2005**



## TABLE OF CONTENTS

|   |           |
|---|-----------|
| <b>SALUTATION .....</b>   | <b>1</b>  |
| <b>SCOPE OF EXAMINATION .....</b>   | <b>1</b>  |
| Period Covered by Examination .....   | 1         |
| Examination Procedure Employed.....   | 1         |
| Status of Adverse Findings, Material Changes in the Financial Statements, and Other<br>Significant Regulatory Information Disclosed in the Previous Examination ..... | 2         |
| <b>HISTORY .....</b>  | <b>2</b>  |
| General .....   | 2         |
| Capital Stock.....  | 2         |
| Dividends to Policyholders .....  | 2         |
| Management.....   | 3         |
| Conflict of Interest Procedure .....  | 3         |
| Corporate Records .....   | 3         |
| Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance  | 4         |
| Surplus Debentures .....  | 4         |
| <b>AFFILIATED COMPANIES.....</b>  | <b>4</b>  |
| Transactions with Affiliates .....  | 4         |
| <b>FIDELITY BOND AND OTHER INSURANCE.....</b>   | <b>5</b>  |
| <b>PENSION, STOCK OWNERSHIP AND INSURANCE PLANS .....</b>   | <b>5</b>  |
| <b>STATUTORY DEPOSITS.....</b>  | <b>5</b>  |
| <b>INSURANCE PRODUCTS AND RELATED PRACTICES.....</b>  | <b>5</b>  |
| Policy Forms and Underwriting .....   | 5         |
| Territory and Plan of Operation .....   | 5         |
| Advertising and Sales Material .....  | 6         |
| Treatment of Policyholders .....  | 6         |
| <b>REINSURANCE .....</b>  | <b>6</b>  |
| Ceded/Assumed .....   | 6         |
| <b>ACCOUNTS AND RECORDS.....</b>  | <b>6</b>  |
| <b>FINANCIAL STATEMENTS.....</b>  | <b>7</b>  |
| Balance Sheet.....  | 8         |
| Capital and Surplus .....   | 10        |
| <b>NOTES TO FINANCIAL STATEMENTS .....</b>  | <b>10</b> |
| <b>CAPITAL AND SURPLUS.....</b>   | <b>11</b> |
| <b>SUMMARY .....</b>  | <b>11</b> |
| <b>CONCLUSION .....</b>   | <b>12</b> |

June 12, 2006

**SALUTATION**

Honorable D. Kent Michie, Commissioner  
State of Utah Insurance Department  
State Office Building, Room 3110  
Salt Lake City, Utah 84114-6901

In accordance with your instructions and in compliance with Utah Code Annotated (U.C.A.) Title 31A, an examination of the financial condition and business affairs of

**OPTICARE OF UTAH  
of  
West Valley City, Utah**

hereinafter referred to as (the Organization), was conducted as of September 30, 2005.

**SCOPE OF EXAMINATION**

Period Covered by Examination

The Utah Insurance Department's (Department) last financial examination of the Organization was conducted as of December 31, 2001. The current examination covers the period from January 1, 2002, through September 30, 2005, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Examination Procedure Employed

The examination included a general review and analysis of the Organization's operation, the manner in which its business was conducted, and a determination of its financial condition as of September 30, 2005. The examination was conducted in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook, while also incorporating top-down, risk-focused examination techniques contemplated in the current draft version on Risk Focused Examinations of the NAIC Financial Condition Examiners Handbook. Tests included reviewing corporate records and accounting practices to determine compliance with applicable laws of the state of Utah, insurance rules promulgated by the Department, the NAIC Accounting Practices and Procedures Manual, and the Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO). It included tests of accounting records and a review of the Organization's affairs and practices to the extent deemed necessary.

A letter of representation certifying that management has disclosed all significant matters and records was obtained from management and is included in the examination working papers.

Status of Adverse Findings, Material Changes in the Financial Statements, and Other Significant Regulatory Information Disclosed in the Previous Examination

Adverse findings noted in the prior report of examination were addressed by the Organization or were identified as repeat exceptions in this report.

## HISTORY

### General

The Organization's articles of incorporation, filed on August 18, 1987, stated the Organization was organized under the Utah Business Corporation Act. It received a Certificate of Authority from the Utah Insurance Department to conduct an insurance business as a limited health plan pursuant to the Utah Code Annotated (U.C.A.) Title 31A, Chapter 8 on January 4, 1988, to provide vision care benefits.

The Organization's bylaws, articles of incorporation and minutes of the board of directors meetings and sole shareholder meetings held during the period covered by this examination were reviewed. There were no amendments made to the bylaws or articles of incorporation during the examination period.

### Capital Stock

As of September 30, 2005, the number of shares of common stock authorized by the Organization was 50,000 at a par value of \$1.00 each. The number of shares issued and outstanding was 23,530. Stephen H. Schubach, the controlling person, owned 85% of the issued shares of common capital stock. Mary McCarthy owned the remaining 15% of the issued shares of common capital stock.

### Dividends to Policyholders

During the period under examination the Board of Directors did not declare and the Organization did not pay stockholder dividends.

### Management

There are no outside directors. Directors serving as of September 30, 2005, were as follows:

| <u>Name</u>                               | <u>Principal Occupation</u>                |
|---|--|
| Stephen H. Schubach<br>Sandy, Utah        | President<br>Standard Optical Company      |
| Mary McCarthey<br>Salt Lake City, Utah    | President<br>Mary McCarthey, L.L.C.        |
| Aaron R. Schubach<br>Salt Lake City, Utah | Vice President<br>Standard Optical Company |

Officers elected by the board of directors and serving at the examination date follow:

| <u>Principal Officer</u> | <u>Office</u>       |
|--------------------------|---------------------|
| Stephen H. Schubach      | President           |
| Aaron R. Schubach        | Vice President      |
| Kenneth A. Acker, CPA    | Secretary/Treasurer |

The Organization did not keep a record of minutes of its shareholder meetings as required by Article II Section 2.02 of the bylaws of the Organization. Without a record of the proceedings of the shareholder meetings the examination could not objectively review evidence of the election of directors and consideration of the Organization's business by shareholders.

### Conflict of Interest Procedure

The Organization had no formal conflict of interest policy with an established procedure for disclosure of any material interest or affiliation that might influence a board member or officer in the performance of their duties.

### Corporate Records

In general, the board of directors meeting minutes indicated the board adequately approved and supported the Organization's transactions and events. A copy of the prior examination report was provided to the board members by certified mail on December 3, 2003, to comply with U.C.A. § 31A-2-204(8).

### Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

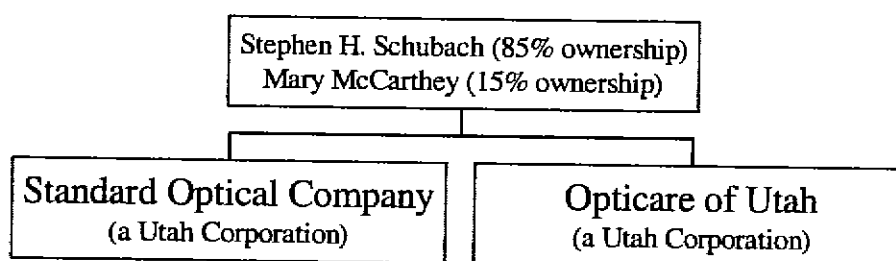
There were no acquisitions, mergers, disposals, dissolutions and purchases or sales through reinsurance that involved the Organization during the examination period.

### Surplus Debentures

No surplus debentures were issued or retired during the examination period and none were outstanding as of September 30, 2005.

### AFFILIATED COMPANIES

The Organization chart below illustrates the holding company system:



### Transactions with Affiliates

The Organization has a Management and Administrative Agreement with Standard Optical Company, amended on January 1, 2005, in which Standard Optical Company provides services relative to general payroll and personnel services; accounting and annual statement services; auditing services; legal services; administration of sales; service to enrollees; collections; establishing, maintaining and storing corporate records; and general office services. The agreement provides for compensation to the affiliate based on a percentage of monthly contract charges collected (premium) of between 5% and 20% as approved by the Department. The Department approved a compensation rate of 12% as of September 30, 2005 and an increase to 20% effective March 1, 2006.

The Organization has a Vision Care Plan Service Agreement with Standard Optical Company, amended on January 1, 2005, in which Standard Optical Company provides vision care services and products including eye examinations, glasses, and contact lenses. The Organization pays Standard Optical Company for these services and products according to a fixed reimbursement schedule.

Effective September 30, 2005, the Organization loaned \$250,000 to Standard Optical of Utah. The Organization submitted a Form D, Prior Notice of a Transaction, to the Department on January 20, 2006, subsequent to the effective date of the loan. The Department approved the loan on February 9, 2006.

## FIDELITY BOND AND OTHER INSURANCE

The Organization had fidelity insurance coverage of \$10,000, an amount that is less than the amount of coverage recommended by the NAIC. For an organization this size the NAIC recommends between \$50,000 and \$75,000 coverage.

The Organization was also a named insured under policies providing property and liability coverage.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Organization has no direct employees and is not a party to any type of retirement plan or deferred compensation plan.

## STATUTORY DEPOSITS

Pursuant to U.C.A. § 31A-8-211(3), the Organization is required to maintain a statutory deposit equal to \$25,000. The Utah State Treasurer held under a tri-party agreement with the Organization and the Department, a U.S. Treasury Bill with a statement value of \$56,237 and a market value of \$56,040.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Policy Forms and Underwriting

The Organization did not comply with U.C.A. § 31A-21-201, because a majority of the examination sample of its group application and individual enrollment forms in use were not filed with the commissioner. In addition, the examination found advertising materials available on the Organization web site describing benefits for plans whose forms had not been filed. This is a recurring deficiency.

There was no underwriting risk, because the policies were guaranteed issue.

### Territory and Plan of Operation

The Organization is authorized to provide optical services as a limited health plan only in the state of Utah as of September 30, 2005.

The vision products of the Organization are marketed by licensed employees of Standard Optical Company and appointed independent agencies and agents. The vision products are presented at trade shows, expositions and health fairs.

### Advertising and Sales Material

The Organization's advertising material included a benefit description for individual and group plans, print media advertisements, and an Organization web site. The Organization distributed material at Standard Optical Company stores, trade shows, expositions and health fairs.

### Treatment of Policyholders

The Organization had a written complaint and grievance procedure in place to maintain control over member complaints. During the course of the examination, there were no complaints filed with the Department.

## REINSURANCE

### Ceded/Assumed

During the period covered by the examination, the Organization neither ceded nor assumed reinsurance. The risks undertaken by the Organization were minimal.

## ACCOUNTS AND RECORDS

The Organization's accounting systems were maintained and processed on the information systems belong to its affiliate, Standard Optical Company. The Organization maintained a general ledger, receipts and disbursements journals, and other subsidiary records both manually and on personal computer equipment.

The Organization's general ledger was maintained on an accrual basis. The examiner footed the Organization's general ledger trial balance and reconciled it to the balance sheet and income statement expenses and surplus contained in the September 30, 2005 quarterly statement. Individual financial statement accounts for the years covered in the examination period were reviewed and reconciled as deemed necessary.

During the period covered by the examination, the Organization was exempted from the requirement to file audited financial statements and electronics filings with the NAIC. Effective December 31, 2005, the Commissioner removed the exemption, because the Organization's direct premiums written exceeded the threshold amount of \$1,000,000 listed in the Annual Statement Instructions. Audited financial statements will be filed for the year ended December 31, 2005, and electronic filings will be filed with the NAIC.



## FINANCIAL STATEMENTS

The Organization's financial condition as of September 30, 2005, and the results of its operations during the nine months then ended, as determined by examination, is reported in the following financial statements:

Balance Sheet as of September 30, 2005

Statement of Revenue and Expenses

Through the Quarter Ended September 30, 2005

Capital and Surplus – January 1, 2002 through September 30, 2005

The accompanying notes to financial statements are an integral part of these statements.

Opticare of Utah  
Balance Sheet  
As of September 30, 2005

**ASSETS**

|   | <u>Amount</u>  | <u>Notes</u> |
|---|----------------|--------------|
| Common Stocks   | \$ 0           | (1)          |
| Cash and short-term investments                                       | 80,583         |              |
| Uncollected premiums and agents' balances in the course of collection | 49,359         | (2)          |
| Receivables from parent, subsidiaries and affiliates                  | 250,000        |              |
| Total assets  | <u>379,942</u> |              |

**LIABILITIES, CAPITAL AND SURPLUS**

|  |                   |        |
|--|-------------------|--------|
| Claims unpaid                          | 86,020            |        |
| General expenses due or accrued        | 21,193            |        |
| Utah sales tax payable                 | (134)             |        |
| Total liabilities                      | <u>107,079</u>    |        |
| Common capital stock                   | 23,530            |        |
| Gross paid in and contributed surplus  | 61,470            |        |
| Unassigned funds (surplus)             | 187,863           | (1)(2) |
| Total capital and surplus              | <u>272,863</u>    |        |
| Total liabilities, capital and surplus | <u>\$ 379,942</u> |        |

Opticare of Utah  
Statement of Revenue and Expenses  
Through the Quarter Ended September 30, 2004

|  |                          |
|--|--------------------------|
| Net premium income   | \$ 1,084,362             |
| Total revenues   | <u>1,084,362</u>         |
| Other professional services: Compensation to non-physician providers | <u>588,110</u>           |
| Total hospital and medical   | <u>588,110</u>           |
| Claims adjustment expenses   | 3,192                    |
| General administrative expenses                                      | <u>405,639</u>           |
| Total underwriting deductions  | <u>996,941</u>           |
| Net underwriting gain or (loss)                                      | <u>87,421</u>            |
| Net investment income earned   | 1,722                    |
| Net realized capital gains or (losses)                               | <u>37,315</u>            |
| Net investment gains or (losses)                                     | <u>39,037</u>            |
| Net income or (loss) before federal income taxes                     | 126,458                  |
| Federal and foreign income taxes incurred                            | -                        |
| Net income (loss)  | <u><u>\$ 126,458</u></u> |

Opticare of Utah  
Capital and Surplus  
January 1, 2002 through September 30, 2005

|  | 2002       | 2003       | 2004       | 30-Sep-2005 | Notes |
|--|------------|------------|------------|-------------|-------|
| Capital and surplus, December 31,<br>previous year       | \$ 223,973 | \$ 191,454 | \$ 41,947  | \$ 293,183  |       |
| Net Income or (loss)                                     | (107,431)  | (149,507)  | 208,986    | 126,458     |       |
| Net unrealized capital gains and losses                  | -          | -          | 27,250     | (26,507)    |       |
| Change in nonadmitted assets                             | 74,912     | -          | -          | (67,375)    | (1)   |
| Surplus adjustments: Paid in                             | -          | -          | 15,000     | -           |       |
| Aggregate write-ins for gains or<br>(losses) in surplus: | -          | -          | -          | -           |       |
| Correction of an error                                   | -          | -          | -          | (52,896)    | (2)   |
| Audit Changes from Prior Year                            | -          | -          | -          | -           |       |
| Net change in capital and surplus<br>for the year        | (32,519)   | (149,507)  | 251,236    | (20,320)    |       |
| Capital and surplus end of reporting<br>period           | \$ 191,454 | \$ 41,947  | \$ 293,183 | \$ 272,863  |       |

NOTES TO FINANCIAL STATEMENTS

(1) Common stocks \$0

The examination non-admitted a single common stock in the amount of \$67,375, because the Organization did not hold the security under a custodial agreement pursuant to U.C.A. § 31A-4-108 and Utah Administrative Code (U.A.C) Rule R590-178.

(2) Uncollected premiums \$49,359

The Organization did not recognize premium as of the effective date; the first day of each calendar month, as required by Statements of Statutory Accounting Principles (SSAP) No. 6, paragraph 7 and SSAP No. 54, paragraph 2. The Organization has historically recognized premium in the month immediately prior to the effective date. The premium recognized as of September 30, 2005 for the subsequent effective date was \$52,896. The examination decreased the reported Uncollected premiums asset amount of \$102,255 by \$52,896.

## CAPITAL AND SURPLUS

The Organization's capital and surplus was determined to be \$120,271 less than reported in the Organization's quarterly statement as of September 30, 2005. The following schedule identifies the examination changes:

| <u>Description</u>                   | <u>Annual<br/>Statement</u> | <u>Per<br/>Examination</u> | <u>Surplus<br/>Increase<br/>(Decrease)</u> | <u>Notes</u> |
|--------------------------------------|-----------------------------|----------------------------|--|--------------|
| Common stocks                        | \$ 67,375                   | \$ 0                       | \$ (67,375)                                | (1)          |
| Uncollected Premiums                 | 102,255                     | 49,359                     | (52,896)                                   | (2)          |
| Total changes                        |                             |                            | (120,271)                                  |              |
| Capital and surplus per Organization |                             |                            | <u>393,134</u>                             |              |
| Capital and surplus per Examination  |                             |                            | <u>\$ 272,863</u>                          |              |

U.C.A. § 31A-8-209(2) requires the Organization to maintain a minimum capital in the amount of \$20,000. As defined by U.C.A. § 31A-17-601, the Organization reported total adjusted capital of \$351,140 and an authorized control level risk-based capital (RBC) requirement of \$62,485 as of December 31, 2005.

The examination determined total adjusted capital to be \$272,863 as of September 30, 2005. The examination accepted the Organization's authorized control level RBC because adjustments made for examination purposes would not have a significant effect on the RBC requirement.

## SUMMARY

Items of significance contained in this report are summarized below:

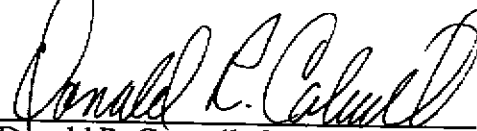
1. Pursuant to U.C.A. §31A-8-209(2) the Organization is required to maintain minimum capital in the amount of \$20,000. The Organization reported total adjusted capital of \$351,140 and an authorized control level risk-based capital (RBC) requirement of \$62,485 as of December 31, 2005. The examination determined total adjusted capital to be \$272,863 as of September 30, 2005. (CAPITAL AND SURPLUS)
2. The Organization had \$10,000 in fidelity insurance coverage, significantly less than the NAIC recommendation of between \$50,000 and \$75,000. (FIDELITY BOND AND OTHER INSURANCE)
3. The Organization did not comply with U.C.A. § 31A-21-201, because forms in use were not filed with the Commissioner. In addition, the examination found advertising describing benefits for plans whose forms had not been filed. This is a recurring deficiency. (Policy Forms and Underwriting)

4. Common stock in the amount of \$67,375 was not allowed by the examination, because it was not held under a custodial arrangement as required by U.C.A. § 31A-4-108 and U.A.C Rule R590-178. (Notes to Financial Statements)
5. Uncollected premiums were reduced by \$52,896 as a correction of an error resulting from premiums being overstated. Premium should be recognized as of the effective date; the first day of each calendar month, to comply with SSAP No. 6, paragraph 7 and SSAP No. 54, paragraph 2. (Notes to Financial Statements)

#### CONCLUSION

Assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Organization are acknowledged. Colette Reddoor, CFE, Assistant Chief Examiner supervised the examination.

Respectfully submitted,



Donald R. Catmull, CFE  
Examiner-in-Charge, representing the  
Utah Insurance Department